

DEPARTMENT OF TAXATION

2010 Fiscal Impact Statement

1. **Patron** John C. Watkins

3. **Committee** Senate Finance

4. **Title** Cigarette Tax; Penalties for Unstamped Cigarettes

2. **Bill Number** SB 476

House of Origin:

 X **Introduced**

 Substitute

 Engrossed

Second House:

 In Committee

 Substitute

 Enrolled

5. **Summary/Purpose:**

This bill would reduce and simplify the penalties related to unstamped cigarettes. The bill would provide that stamping agents who fail to properly affix revenue stamps be required to pay a penalty of \$2.50 per pack, up to \$500, for the first violation by a legal entity within a 36 month period, \$5 per pack, up to \$1,000, for the second violation by the legal entity within a 36 month period, and \$10 per pack, up to \$50,000, for the third or subsequent violation by the legal entity within a 36 month period. The stamping agent would be required to pay a civil penalty of \$25 per pack, up to \$250,000, where willful intent exists to defraud. Persons other than stamping agents who sell, purchase, transport, receive, or possess unstamped cigarettes, except as otherwise provided by law, would also be subject to the same civil penalties.

The effective date of this bill is not specified.

6. **Fiscal Impact:** Unknown (See Line 8.)

7. **Budget amendment necessary:** No.

8. **Fiscal implications:**

Administrative Costs

TAX would not incur any costs in the implementation of this bill.

Revenue Impact

The revenue impact of this bill is unknown, but minimal. The current penalty structure results in penalties so large that taxpayers typically appeal them to the Tax Commissioner, file an offer in compromise to pay less than the full amount of the penalty, or are unable to pay them at all. While this proposal would reduce the penalties for unstamped cigarettes, the bill may increase the likelihood that taxpayers will actually pay the penalty.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

Background

In recent years, TAX has discovered numerous situations where stamping agents fail to affix stamps to cigarettes due to machine error or where stamping agents inadvertently ship unstamped cigarettes to retailers due to human error. TAX typically discovers these unstamped cigarettes when it audits cigarette retailers. Although in a very limited number of cases, TAX has determined that the possession of unstamped cigarettes by retailers was motivated by an intent to evade the tax, in the vast majority of these cases, TAX has determined that the unstamped cigarettes were due to machine error or negligence. TAX has worked with stamping agents to develop policies to ameliorate this situation. As a result, TAX has issued two Tax Bulletins, Virginia Tax Bulletin 07-3 (March 15, 2007) and Virginia Tax Bulletin 08-13 (December 11, 2008), setting out more relaxed penalty structures.

In addition, TAX has issued procedures to allow retailers who have been audited by TAX and found to possess unstamped cigarettes to obtain affidavits from stamping agents stating that the stamping agent was the source of the unstamped cigarettes. Once a stamping agent has issued such an affidavit, TAX will typically issue a warning letter or penalty to the stamping agent instead of the retailer. The stamping agent may then file an appeal or offer-in-compromise with TAX and seek a reduction or abatement of the penalty. Despite these efforts to come up with a workable penalty structure, stamping agents and retailers are still filing administrative appeals regarding unstamped cigarette audits in almost every instance.

In addition to criminal penalties, the *Code of Virginia* currently provides very stiff civil penalties for cigarette stamping agents who fail to affix Virginia revenue stamps to cigarettes and to other persons who sell, purchase, transport, receive, or possess unstamped cigarettes with the intent to evade the tax. Stamping agents who fail to properly affix revenue stamps are currently subject to a civil penalty of \$250 a pack if the amount of unstamped cigarettes is 100 packs or less, and \$500 a pack if the amount of unstamped cigarettes exceeds 100 packs. Where willful intent to defraud the Commonwealth of the cigarette tax exists, the stamping agent is subject to a penalty of \$2,500 a pack. Any other person who sells, purchases, transports, receives or possesses unstamped cigarettes for the purpose of evading the tax is subject to a civil penalty of up to \$500 a pack if the amount of unstamped cigarettes is less than 3,000 packs, and up to \$2,500 a pack if the amount of unstamped cigarettes is 3,000 packs or more.

The industry typically packages 10 packs of 20 cigarettes in each carton, and 50 cartons in each master case. As the state tax is currently imposed at a rate of \$0.30 per pack of 20 cigarettes, if TAX discovers one case of unstamped cigarettes in a retail location, the statutory civil penalty could be as much as \$250,000 even though the unpaid state tax is

only \$150. If TAX discovers 3,000 unstamped packs, the minimum amount for a retailer to be subject to the highest penalty, the statutory penalty could be as much as \$7.5 million, although the tax owed would only be \$900. Under this bill, the penalty would be \$500 for both situations, if it was a first violation.

Most states use criminal prosecutions to enforce compliance with their cigarette tax law. Virginia and Alabama are among a very few states in the country which use heavy civil penalties to enforce compliance with their cigarette tax laws. A few states, including Louisiana and Iowa, have adopted similar graduated penalty structures.

Proposal

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Similar Legislation

House Bill 820 is identical to this bill.

House Bill 874 would change the time for affixing tax stamps to cigarette packs from one business day after receipt to prior to shipping to other wholesale dealers or retail outlets.

cc : Secretary of Finance

Date: 1/17/2010 AM
DLAS File Name: SB476F161